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# **Quarterly Bulletin on Soviet Economic Growth**

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**Second Quarter 1987**

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*SOV SEG 87-003  
August 1987*

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## **Quarterly Bulletin on Soviet Economic Growth**

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**Second Quarter 1987**

This bulletin was prepared by  
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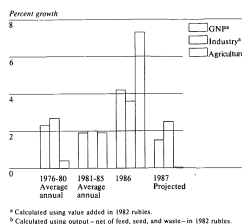
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## USSR: An Economy in Transition

## A. Sluggish Economic Growth So Far in 1987

The Soviet economy was hit hard early in the year by severe winter weather and new measures intended to make the system work better—state inspection of industrial output, new managerial practices for all of industry, and experiments in self-finance in several industries. By midyear, performance was improving gradually, with better weather and adaptation to the new arrangements in industry. The improved performance was achieved with only a small increase in overall employment and a slight decline in industrial employment.

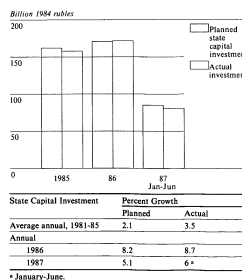
The outlook is for slow economic growth this year. GNP is likely to be 1 to 2 percent higher than in 1986, and industrial output will probably rise by 2 to 3 percent. In agriculture, production is likely to roughly match last year's record level. A Central Committee plenum in June endorsed—and the Supreme Soviet sanctioned—sweeping changes in the economic system (see appendix). For the most part, these new measures will take effect beginning next year, but large-scale preparation will be needed in 1987.



## D. Investment Rising, But Modernization Lagging

State capital investment—about 90 percent of total investment—reportedly increased by 6 percent during the first six months of 1987, but commissions of new capacity were far below plan targets in almost all sectors. The official report on midyear performance criticized the construction sector for lags in completing projects and for a failure to concentrate on priority projects. Despite extensive investment in the machine-building sector over the past two years, plans for introducing new kinds of equipment and new manufacturing technologies fell substantially short of official goals during the first half of 1987.

The reported increase in state investment appears high compared with growth of the machinery and construction sectors, which provide the bulk of investment resources. Trends in foreign trade, moreover, does not indicate that machinery imports have increased to supplement domestic output. It is possible that stocks of equipment are being drawn down for investment this year, but official claims of investment growth may simply be exaggerated.



## B. Industry: Adapting to New Arrangements

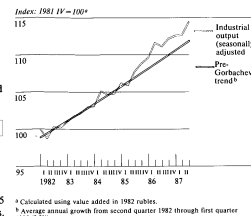
Industrial production in the first half of 1987 was only about 1.5 percent higher than in the same period last year. Growth picked up in the second quarter, however, and production (seasonally adjusted) was roughly 2.5 percent higher than last year. Although machinery output was 2 percent below its mid-1986 level, performance improved as the year progressed. Energy production continued to do well; output of all major fuels was higher than a year ago.

Most of the second-quarter improvement in industry was due to the machine-building sector's recovery. Gradual adaptation to state quality control—apparently played a key role in the turnaround. The rejection rate of industrial goods appears to be falling, but it is unclear whether this is due to an upgrading of previously rejected products, an improvement in the quality of new output, or an easing of inspection standards.

Industry has been constrained this year by new managerial arrangements and by Gorbachev's program to modernize facilities. New financial require-

ments apparently are causing confusion and may be impeding production in some ministries. At the same time, managers and workers are facing a variety of conflicting demands. The quality of output is supposed to rise sharply, for example, but plans to increase the quantity of production are no less ambitious than before. Enterprise managers are being told to extensively retool their factories, but at the same time adopt multiple work shifts and keep production lines operating with little or no downtime.

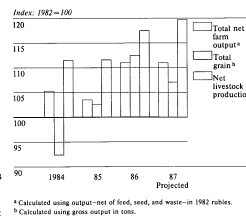
On the other hand, wage reforms have helped boost labor productivity by encouraging cuts in the work force in order to raise the pay of employees. Soviet officials report that total employment in industry is slightly lower than it was a year ago and that 10 to 15 percent of the work force has been cut in some sectors.



## E. Farm Production: No Change

We estimate that, despite weather-related problems affecting both crop and livestock production, farm output will roughly match last year's record high. At the halfway mark, it appears that a drop in crop production is likely to be offset by continued gains in the livestock sector.

Assuming average weather for the remainder of the crop season, grain output should reach about 200 million tons, 10 million tons less than last year. Cotton is the only bright spot among other major crops; favorable growing conditions indicate that output will be well above the depressed 1986 level. At midyear, meat production in the socialist sector was up about 7 percent. The forage harvest is progressing well, and improved roughage availability should enable continued growth in meat production for the rest of the year, although at rates lower than in first half 1987. The delivery of more fertilizer and feed additives has helped farms to raise production, but deliveries of tractors and needed feed-harvesting machinery failed to meet plan targets.



## F. Continuing Trade Problems, No Quick Solutions

According to preliminary Soviet data, the value of exports to the developed West during the first quarter of 1987 was roughly the same as in the corresponding period last year. Exports to Eastern Europe were cut by nearly 8 percent, while exports to the LDCs rose by an estimated 9 percent, mostly due to increased arms sales on credit. Imports were down an estimated 10 to 15 percent—largely reflecting reduced grain purchases; deliveries from Eastern Europe, however, held steady.

The leadership hopes that joint ventures with foreign firms will help resolve its trade problems. However, we believe that joint ventures with Western firms are unlikely to have much impact on Moscow's hard currency position during the next few years. Only five agreements have been approved to date by the Council of Ministers. Moscow has apparently decided to limit the number of joint enterprises to 20 to 25 during the next year or two, in the hope that close supervision of these enterprises will assure their success.

## C. Official Concern for the Consumer

The consumer's lot improved little in the first six months of 1987—total retail sales, for instance, stagnated. Meanwhile, wages increased at about their usual rates, widening the gap between the purchasing power of Soviet consumers and the availability of goods and services. Moscow appears worried that output and quality are not growing fast enough to provide incentives for harder work. The leadership complained in May that goals for consumer goods and services were not being met, and in June Gorbachev called several ministers of consumer-oriented sectors to task for unsatisfactory performance. The midyear economic report contained unusual references to the high prices of food in collective farm markets and to food shortages in state trade outlets.

Some workers reportedly feel they have not yet benefited from *perestroika* (restructuring) and resent its increased demands on them. Dissatisfaction with state quality control has surfaced in complaints about unpaid overtime for corrective work and in "conflicts" between inspectors and plant employees. Strikes have been threatened at a number of factories.

## Joint-Venture Agreements Signed or Likely To Be Concluded in 1987

Western Firm	Project
Burda (West Germany)	Printing of a Russian edition of the fashion magazine <i>Burda</i>
Finnair (Finland)	Refurbishment of Hotel Berlin in Moscow
FATA (Italy)	Production of freezers and cold-storage containers
Heinemann Machine and Installation Construction (West Germany)	Production of machine-tool equipment for various engineering industries
Mineraloil and Rohstoff Handel (West Germany)	Production of ethylene glycol
Suomen Kati-Myynti Osakeyhtiö (Finland)	Production of women's clothing
Sadolin (Finnish subsidiary of Danish Sadolin)	Production of paints and wood preservatives
Salamander (West Germany)	Production of shoes at two plants
Tairiki Boki (Japan)	Processing of high-quality, Siberian broad-leaved trees into furniture paneling

\* Already signed.

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## Appendix

### Implications of Gorbachev's "New Economic Mechanism" for Near-Term Economic Growth

A program for comprehensive economic reform in the Soviet Union was approved at the June sessions of the Central Committee plenum and USSR Supreme Soviet (see table). Guidelines outlining a "new economic mechanism" and 11 draft decrees detailing changes in major aspects of the economy were ratified. Also approved was a new law on state enterprises designed to expand their decisionmaking power and to force them to be financially responsible for their activities.

The "new economic mechanism" is designed to sharply reduce central control over economic activity in the USSR and to broaden the scope for market forces. The state would continue to ration the most important products and to set prices for those goods. After providing for production to fill mandatory state orders, enterprises would decide independently what to produce with their remaining capacity, "freely choose" their own suppliers and customers, and have greater latitude in setting prices.

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#### Gorbachev's Economic Reform Program

Key Issue	Outlined Changes	Potential Problems
Planning	Enterprises will produce a portion of their output in compliance with mandatory state orders and will be given greater latitude in determining the remainder. The state will no longer approve annual plans, and the five-year plans will become the "main" production blueprint.	Enterprise autonomy in production decisions will depend on the proportion of output procured by the state and the degree of freedom allowed in selecting suppliers and setting prices. Ministries continue to be allowed to "monitor" enterprise performance.
Prices	The system will be changed so that output with centrally fixed prices will be greatly reduced and include only the most important products. Enterprises will receive expanded rights to set contractual prices with customers. Unjustified state subsidies will be reduced.	The move to a more rational price system could be frustrated by the retention of centralized prices for key commodities, limited flexibility to respond to changing market conditions, and reluctance to take measures to avert inflationary pressures and to eliminate subsidies for consumer staples.
Supply	Only "scarce" producer goods will continue to be rationed by the state. Other supplies will be distributed through a wholesale trade system that will allow free purchase and sale under direct contracts between providers and users.	Effectiveness will depend on the length of the list of "scarce" producer goods, the ability of enterprises to choose their suppliers freely, and the balance in the market for producer goods.
Finance and Credit	Enterprises will bear full economic responsibility for the results of their activity. Investment will be financed less through budget allocations and more through bank credits.	Success will depend on the enterprise's ability to obtain investment capital and earn profits to be self-supporting. It is unclear to what extent enterprise losses will continue to be covered by the state or unprofitable firms closed.
Wages	Ceilings on wages will be eliminated, and a general reform of wages will be implemented.	Pay increases, which will depend on enterprises' ability to finance them from funds related to productivity increases, could lead to large inequities. Unacceptably wide income differentials and increased demand for consumer goods could result.

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### ***Politburo Promotions Consolidate Gorbachev's Political Power***

*Three party secretaries—Aleksandr Yakovlev, Nikolay Slyun'kov, and Viktor Nikonov—were promoted to full Politburo membership at the Central Committee plenum in June 1987. These promotions—the first such additions to the Politburo since the party congress in March 1986—should greatly improve General Secretary Gorbachev's ability to move ahead with his agenda for economic reform. The personnel changes should, for example, dilute the power of "Second Secretary" Yegor Ligachev, who appears to be acting as a spokesman for more conservative party members resisting some of Gorbachev's programs:*

- *Yakovlev apparently will supplant Ligachev as senior secretary for ideology.*
- *Nikonov will be senior secretary for agriculture, a sector in which Ligachev has been active.*
- *Slyun'kov is in charge of overseeing the implementation of Gorbachev's reform program.*

*In addition, the promotion of Defense Minister Dmitry Yazov to candidate membership gives Gorbachev the political clout needed to keep a firm hand on the military.* [ ]

*Although the plenum's outcome demonstrates Gorbachev's political strength in a dramatic way, there are still real limits to the General Secretary's power. Moscow party leader Boris Yel'tsin, for example, was not elevated to full Politburo membership even though Gorbachev reportedly pushed for it.* [ ]

The endorsement of these wide-ranging initiatives together with the addition at the plenum of three full members to the Politburo (see inset) gives General Secretary Gorbachev both an approved agenda and the political base to move ahead with his effort to revitalize the Soviet economy. But the hardest part of the campaign lies ahead—designing a system of price formation that will provide acceptable signals to the enterprises, managing a transition to greater reliance on wholesale trade instead of centrally directed deliveries, and building new credit-financial institutions. In implementing the reforms, Gorbachev faces stiff resistance from ideologues and bureaucrats. Workers, facing the prospect of having to work harder and with

less job security, and managers, being asked to function in a more uncertain and stressful environment—where they are expected to be more innovative and independent—also are likely to resist his programs. In addition, ways will have to be found to curb the “petty tutelage” that planners and the party have exercised over enterprises. In other words, the political consensus forged at the plenum could easily break down when implementation of the new programs begins.

Parts of the reform are patterned after new managerial arrangements currently being implemented. According to the Soviet press, these innovations have caused confusion and financial difficulties at the enterprise level that are impeding production. In some light-industry plants, for example, customers' overdue debts have reached amounts equaling half a month's sales, making it difficult for these enterprises to purchase sufficient quantities of raw materials and other supplies needed to maintain production. [ ]

Because most of the changes outlined at the June plenum are scheduled to be introduced quickly—during the next three years—they are likely to cause disruptions more serious than those encountered in 1987. Tinkering with the central supply network, for example, could cause confusion as enterprise managers struggle to establish new sources of inputs and to find customers for their products. In the latter half of the 1950s and early 1960s, Nikita Khrushchev pushed through major changes on a broad front—the “virgin lands campaign,” a crash program to develop the chemical industry, and major reorganizations of the administrative bureaucracy. The consequence of trying to change too much too fast contributed to a fall in GNP growth from about 7 percent per year during the period 1955-58 to about 3 percent per year during 1959-63. [ ]

The changes launched by Gorbachev might be even more disruptive, causing dislocations and bottlenecks in the near term that could slow GNP growth during the remainder of the decade. The Soviet leadership, however, believes that by the 1990s the economic reforms will have been digested and the cumulative effects of the program to modernize the country's plant and equipment will be felt. It is counting on these two developments to support a 5-percent annual growth in GNP in the 1990s. [ ]

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